The US-West European Economic Relationship

The maturation of the European economies over the past three decades has greatly strengthened economic ties with the United States.

- Merchandise trade between the two economic powers has increased by more than threefold since 1970 and now approaches $100 billion annually.
- Direct investment in both directions provides millions of jobs for each economy.
- Foreign earnings have grown rapidly and contribute billions of dollars each year to the economic relationship.
- The financial interplay has built an international banking system that services the whole world.

The Soviet Bloc is a decidedly less important export market than the United States for most of Western Europe. The sole exception, is West Germany, whose sales to the United States and the Bloc are roughly equal if the East German exchange is included. Trade with the Bloc is nonetheless important to Western Europe for political as well as economic reasons.

The accumulated economic disputes now affecting US-European relations reflect structural economic changes and philosophical differences as well as discrete trade issues. European subsidies involved in a number of US trade complaints are claimed by the EC to be necessary to facilitate industrial rationalization. Other economic issues are related as much to differences over East-West policy as trade.

European reactions, although highly vocal, almost certainly will continue to be moderated by a desire to avoid escalation of economic conflict with the United States. ~~Perhaps the most profound~~ effects The ~~of~~ current disagreements could ~~will~~ be reflected in non-economic areas, notably those involving INF deployment and other security issues.

US-West European Economic Linkages

Trade Flows

While the economic exchange clearly benefits both sides, on balance the United States seems to gain the most. In financial terms the United States consistently runs a surplus with Europe. On trade alone, the surplus peaked at $14 billion in 1980 and then fell back to $8 billion in 1981; for the period 1975-81 as a whole, it averaged about $7 billion annually. As a percentage of total trade, however, the surplus has remained relatively stable over the last decade. In 1980, American businesses sold 23 percent of their ~~its~~ exports in the European Community. On the other hand, EC countries shipped only 7 percent of their foreign sales to the United States -- 13 percent when excluding intra-EC trade.

The importance of the European market for US exports is surprisingly similar across commodity groupings. For example, nearly two-fifths -- $20 billion worth -- of our exports to the EC are machinery; those sales account for 23 percent of total US machinery exports. Other important US commodities exported to the EC include crude materials (mainly non-ferrous ores and unwrought metals) amounting to over $7 billion in 1980 as well as food, semifinished goods, chemicals and manufactured products each netting about $5 billion or so; sales to the EC account for 20 to 30 percent of total US exports of those commodities.

US trade with the European Community has expanded appreciably over the last decade. In nominal terms, exports to the EC grew at an average annual rate of about 17 percent between 1971 and 1981. While the importance of US trade with the EC relative to other partners has diminished compared to the 1960s, it has changed little since the mid-1970's. The EC's share of US exports was about the same in 1981 as it was in 1975.

The overwhelming bulk of Europe's foreign trade is intra-continental. Of the $600 billion exported in 1981 by EC countries, about half went to other EC members. Nonetheless, the US market remains the single largest market outside Western Europe and in 1981 accounted for $40 billion in EC export earnings. In real terms, the United States also is providing one of the major growth markets for European goods. Driven primarily by the sharp appreciation of the dollar over the last two years, European exports to the United States in 1981 jumped by more than 20 percent in volume while increasing by a mere 3 percent in dollar value. Buoyant export growth should continue if the dollar remains strong and the US economy continues to gain strength.

Two-fifths of EC sales to the US market also consist of machinery, but that represents only 7 percent of EC exports of machinery worldwide. The next two major categories of goods shipped here are basic products and other manufactured goods -- accounting for 5 percent ($7 billion) and 6.5 percent ($4.3 billion) of world sales of those commodities, respectively. Basic goods are composed primarily of diamonds and steel while scientific equipment accounts for much of the other manufactured goods.

Direct Investment

Investment flows between Europe and the United States rival trade in economic importance. Based on a 1981 survey by the Department of Commerce, the assets of European affiliates of US multinationals totaled $188 billion in 1977 -- over 40 percent of total US fixed assets abroad. By now these assets could well top $200 billion. Equally important, those affiliates provided jobs for 2.6 million West European workers. Growth of US assets in Western Europe over the previous 10 year period averaged 15 percent annually, making Western Europe one of the fastest growing regions for US foreign investment.

West European investment in the United States traditionally has been less important, but has picked up sharply in recent years. The Europeans have over $50 billion invested in the United States in companies ranging from Aetna Insurance to American Motors. European interest in investing in the United States should remain high despite relatively less attractive prices brought on by the dollar's appreciation. The economic outlook in the United States, relatie lack of restrictions, and the political stability perceived here add to the attractiveness of the United States for European investors. Another motivation for buying American plants is to keep abreast of technological developments in high growth industries.

Foreign Business Earnings

In 1980, 65 percent of the $6.9 billion earned in royalties by US firms came from Western Europe. Most of the $770 million in US payments of royalties to foreign firms went to West European companies, primarily to the chemical, food, and metal industries. Similarly, US receipts of direct investment income from Western Europe during 1970-80 rose more rapidly than those from any other region, growing from $2.4 billion in 1970 to $16.1 billion in 1980. Thus, the West European contribution to total US investment income jumped from 29 percent to 44 percent. Payments to foreign companies, primarily headquartered in the Netherlands, the United Kingdom, and West Germany, grew from $875 million in 1970 to $9.3 billion in 1980.

Comparison with the Soviet Bloc Relationship

Regardless of the disparity in the US-European trade relationship, the US market is still far more important than the Soviet market for most European exporters. Sales to the Soviet Bloc account for only 3.1 percent of EC exports, and the share of the Soviet Bloc has been steadily losing ground. EC exports to the Bloc grew rapidly during the early 1970s, approaching parity with EC exports to the United States by 1975. During the ensuing six years, however, EC sales to the US market outstripped EC sales to the Bloc by a cumulative total of $73 billion. By 1981, the EC was selling twice as much to the United States as to the USSR and Eastern Europe combined -- $40 billion compared with $19 billion. On a commodity basis, the Europeans rely on the Bloc primarily as a source of energy supplies and as a market for manufactured goods.

The relative importance of trade with the Soviet Bloc for the major European countries ranges from near parity with the US market for West Germany to a 5:1 ratio in favor of the United States in the case of Britain. In all cases, the trade relationship with the Soviet Bloc constitutes nearly the total of the economic exchange; financial and investment exchanges mainly exist to facilitate trade. While all of the countries prize the economic benefits of trade with the Soviet Bloc, they place greater importance on the political and security ramifications of this commerce. The West Europeans believe that their economic ties with the Bloc will gradually improve their over-all relationship with the East and reduce tensions.

Although trade with the Soviet Bloc is in general only a small share of total EC trade, the Bloc is an important market for a few products -- particularly steel and machine tools. About 30 percent of West German steel plate and sheet exports go the USSR; more imporantly, over 60 percent of its high-pressure steel pipe exports are sold to the Soviet Union. Mannesman, A.

G., which has been delivering larger-diameter pipe to the USSR for more than 20 years, has a plant in Essen producing pipes almost exclusively for export to the Soviet Union. France and Italy also look to the USSR as a major market for pipe exports; this market accounts for 26 percent and 15 percent respectively of their steel pipe exports. In 1980 about 14 percent of West German exports of machine tools went to the USSR.

The Current US-West European Economic Conflict

The specific trade disputes now affecting US - European relations in some regards are symptoms of deeply rooted structural economic problems. Unemployment is approaching 10 percent of the workforce in Western Europe, or some 16 million workers, and is much higher among certain politically sensitive groups and regions. The unemployment rate for people under 25 years old is over 20 percent; it is also highest in Britain's north, France's east, Belgium's Wallonia, and Italy's Mezzogiorno. West European governments fear that the unemployment problem will stay with them for the remainder of the 1980s, even should economic growth accelerate. People born during the baby boom of the 1960s will be entering the labor market faster than most European economies will be able to create jobs.

Europe was also late to enter the new high-technology fields and slow to develop competitive products. This lack of fast-growth industries has complicated the process of rationalizing traditional industries. While it is not clear which is cheaper

-- the subsidies needed to keep inefficient factories operating or the welfare costs of closing them -- it is certain that the social and political costs are less with fewer people out of work.

The specific disputes that are currently disturbing the US - European relationship include:

o <u>Agriculture</u> Under the EC's Common Agricultural Policy, massive Community subsidies for wheat, sugar, meat, and dairy production have resulted in burgeoning exports to third countries -- often to the detriment of US farmers. US attempts to challenge these exports are viewed by the EC as a violation of bilateral EC-US understandings and agreements reached during the Tokyo Round of GATT negotiations. US investigations of certain EC agricultural exports to the US (such as sugar, wheat, flour, and citrus fruits) under section 301 of the Trade Act of 1974 which have further strained relations. Particularly irksome for the United States has been the Commission's contention that in order to ~~climate~~ the EC wheat surplus, the Community must restrict imports of US non-grain animal feed ingredients, such as corn gluten and soybeans.

o <u>Steel</u> The recent US finding against the steel exports of seven EC countries has led to accusations that Washington has violated commitments made within the OECD and at the recent Versailles summit. The EC claims that subsidies are part of its restructuring program for the steel industry and intended to help modernize outdated facilities, not to promote exports. Since 1974, about 250,000 EC steel workers have been laid-off -- 30 percent of the industry's workforce -- and at present capabity utilization is down to around 60 percent. The EC further has challenged the interpretations and accounting methods used in the US investigations.

o <u>Textiles</u> The US protest over recent EC negotiations with Hong Kong to allow for "outward processing" of EC manufactured textiles has created a storm of indignation within the Community. The EC claims that such arrangements are traditional, recognized in the Multifiber Agreement, needed for the restructuring of EC textile industry, and do not violate GATT principles. The EC is especially annoyed that the US is trying to challenge bilateral EC trade arrangements with third countries. This dispute comes on the heels of an earlier textile problem involving EC claims that US exports of synthetic fiber were unfairly priced in the EC market because of the impact of US natural gas price controls on petrochemical costs. Earlier this year, the Community imposed anti-dumping duties against imports of some US synthetic fibers.

o <u>Export Credits</u> A new "Gentlemen's Agreement" on OECD export credits was agreed to last month which largely
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removed that issue from US-EC contention. Remaining,

further [illegible]

however, are differences over credits to the Bloc. The Europeans agreed at Versailles to periodic reviews and improved data sharing. Even that may be in jeopardy because of our extending export controls related to the pipeline.

o <u>Interest Rates.</u> The West Europeans view continued high US interest rates as a strong drag on economic recovery by draining away investment badly needed by European industries. Moreover, the spillover effects on West European interest rates, they maintain, have contributed to the economic slump and unemployment.

o <u>Exchange Rates</u> Another sore point with the West Europeans is US unwillingness to intervene in exchange markets to stabilize the value of the dollar. European leaders argue that frequent and significant fluctuations in the dollar increses uncertainties and adds to recessionary pressures. Dollar appreciation has substantially boosted costs of European imports of energy and other dollar - denomonated commodities.

o <u>Siberian Pipeline</u> The recent extension and expansion of the US embargo on equipment for the Siberian Pipeline has produced perhaps the strongest reaction in Western Europe and has colored the EC attitude toward other outstanding economic disputes as well. The West Europeans especially reject the extraterritorial implications of the embargo as an infringement on their sovereignty and resent its retroactive application to existing contracts. They also claim that the US decision violates recent understandings reached at the Versailles and Bonn summits.

European Reactions and Implications

The Europeans have reacted to the accumulation of economic irritations with anger and frustration and with an unusually unified voice. Individually and as a group they have criticized the US embargo on pipeline equipment, accused the United States of unilaterally interpreting and redefining international trade agreements, and charged that Washington is pushing the world toward a more protectionist attitude at a particularly weak stage of economic activity.

The EC Commission, as the spokesman for trade matters, has stated its determination to defend members' trade interests within the GATT, the OECD, and the courts. So far the Community has:

- o begun a formal challenge of the DISC program at the GATT Council;
- o agreed at the foreign minister level to consider formal GATT hearings on the procedures and interpretations involved in the US investigation of EC steel exports;
- o mandated the Commission to study quota restrictions on US exports of corn gluten and requested for consultations with the United States under GATT Article XXII.

Rhetoric aside, response so far has been limited, probably reflecting a desire on Europe's part to contain the damage. No one wants to escalate the disputes into a trade war. The Europeans are anxious to reach an agreement on the steel issue and are seeking expanded consultations on interest rate policy and exchange market intervention. The EC Council has called for an effective dialogue with the United States but has vowed to defend its legitimate interests. In the extreme, retaliation will probably be limited to restricting imports of selected American products to produce damages roughly equal to European losses.

Probably more disturbing to the Europeans than the specific trade disputes, which they could deal with, is the uncertainty the disputes have engendered regarding US foreign economic policy. In particular, extraterritorial extension of the US pipeline embargo soon after the Versailles Summit reinforced doubts about the Summit process and US willingness to engage in meaningful consultations. West European leaders are concerned that the United States has effectively abandoned bilateral consultations and understandings. Furthermore, the EC claims that recent US actions on steel and agricultural products also were taken without proper multilateral consultations.

West Europeans are concerned about what they view as Washington's desire to wage economic warfare against the Soviet Union. The US pipeline embargo and tough policies on export credits contribute to this concern. Trade with the Soviet Bloc is important to the West Europeans for both economic and foreign policy reasons. Furthermore, the West Europeans are upset by continuation of US grain sales to the USSR and consideration of a new long-term grain agreement at a time when Washington is pressuring them to limit trade.

If economic tensions between the United States and Western Europe continue, or even increase, this could lead to reduced cooperation on security and foreign policy matters. West European attitudes toward START and INF could well be affected. If the Europeans perceive that the United States is principally to blame for an overall deterioration in East-West relations -- a feeling reinforced by the pipeline sanctions--they will be less sympathetic toward the US position. They fear that arms control efforts have little prospect of success while economic warfare between East and West is being waged. Thus, if the talks collapse or achieve little, the Europeans are more likely to blame US policy than Soviet. This in turn may fuel popular support for the peace movement and opposition to INF deployment in Western Europe.

In Belgium, the steel dispute may lead directly to a change in attitude toward cruise missle deployment. The current Martens government could conceivably be brought down should the US enact countervailing duties, thereby triggering an increase in unemployment and perhaps a repetition of last spring's riots. A new government might be considerably less amenable to US plans to deploy INF on Belgian soil.

The extraterritorial extension of US pipeline sanctions has reinforced the tendency of West European officals to link together all their disputes with the United States. Since the Europeans view the disputes as a package, they are likely to look for a blanket solution. Given the structural economic problems and philosophical differences underlying most of the disputes, a reaffirmation of US concern for West European interests is perhaps what they seek most.

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